
IN THE MATTER OF THE ARBITRATION BETWEEN
FIRST STATE INSURANCE GROUP,

Petitioner

and

NATIONAL CASUALTY COMPANY,

Respondent

VOLUME: II

PAGES: 336-693

BEFORE PANEL MEMBERS:

R. Michael Cass, Chairman

Paul N. Steinlage

Dennis C. Gentry

Date: Wednesday, February 11, 2004

Held at: Wyndham Hotel

89 Broad Street

Boston, Massachusetts

Commence: 9:00 a.m.

Reporter: Judith McGovern Williams,

CSR, RPR, CRR

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1 we are having a dialogue on that issue --

2 MR. GURA: I just wanted to make
3 sure I understood.

4 ARBITRATOR GENTRY: -- wouldn't
5 the determination that a given policy
6 relates to a loss automatically attach a
7 treaty or make it subject to a treaty,
8 whether or not it is covered under that
9 treaty with all the exclusions and other
10 terms and conditions? But once the policy
11 pays out something, under these contracts
12 as I understand them, you're going to have
13 coverage under the contract unless it is
14 otherwise excluded by some means, so, you
15 know, it is not casualty, for some reason?

16 MR. GURA: Right. Or it is one
17 of the enumerated exclusions.

18 ARBITRATOR GENTRY: Yes.
19 (Witness excused.)

20 CHAIRMAN CASS: Okay? Mr. Gura,
21 your case -- you have closed your direct
22 case?

23 MR. GURA: We reserve our right
24 on rebuttal, but other than that, yes.

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1 Q. And can you give the Panel an idea of the
2 types of responsibilities that you have in
3 that position?

4 A. I am generally responsible for the assumed
5 reinsurance book of business assigned to
6 Nationwide Indemnity on a domestic basis,
7 all the domestic business, coming from
8 Wausau, National Casualty, Nationwide,
9 Farmland, and Underwriters.

10 Q. So kind of like First State, Nationwide
11 Indemnity handles run-off business for
12 discontinued operations of either
13 Nationwide Mutual Insurance or any of a
14 number of its affiliates?

15 A. That's correct. It is generally treaty
16 casualty business that is running off.
17 Although there may have been property, it
18 is all pretty much run-off.

19 Q. And correct me if I am wrong, Fred, but I
20 think you have been doing that pretty much
21 since you joined the organization?

22 A. Yes. In varying roles since I joined in
23 1996.

24 Q. That is pretty much all you have done? In

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1 CHAIRMAN CASS: We will take
2 until 2:30, and they will start National
3 Casualty's direct presentation.

4 (Recess taken at 2:23 p.m.)

5 (Recess ended at 2:35 p.m.)

6 (Witness sworn.)

7 FREDERICK C. SCHAEFER

8 DIRECT EXAMINATION

9 BY MR. KAREKEN:

10 Q. Good afternoon, Mr. Schaefer.

11 A. Good afternoon.

12 Q. Could you state your full name for the
13 record, please?

14 A. Frederick C. Schaefer, S-C-H-A-E-F-E-R.

15 Q. Do you mind if I call you Fred?

16 A. Go ahead.

17 THE WITNESS: And you, too,
18 Mr. Gura.

19 MR. GURA: Thank you.

20 Q. Could you tell us what your present
21 position is with Nationwide Indemnity
22 Company?

23 A. Yes. I am the director of reinsurance
24 claim and legal.

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1 other words, you have only handled
2 reinsurance matters on behalf of any of
3 those companies since you joined the
4 Nationwide group of companies, so to
5 speak?

6 A. That is correct. Only assumed
7 reinsurance.

8 Q. And you have a law degree; correct?

9 A. Correct.

10 Q. And a license to practice law in
11 Wisconsin?

12 A. Wisconsin and Illinois.

13 Q. Illinois. Okay. In fact there was a
14 period of time when you actually practiced
15 law at various law firms?

16 A. Yes. When I was in Chicago, I practiced
17 for two firms, Brenner & Moltzen and
18 Purcell & Wardrope.

19 Q. Correct me if I am wrong, Fred, but I
20 think you were doing, at least at one of
21 those firms, insurance-related type
22 matters?

23 A. Yes. At Brenner & Moltzen I was doing
24 coverage work for various insurance

55 (Pages 549 to 552)

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1 Q. I am showing you First State Exhibit 99.
 2 (Handing FS Exhibit No. 99 to
 3 the witness.)
 4 Q. I believe this is the First State-prepared
 5 list of audits that you attended. Does
 6 that square with your recollection
 7 generally?
 8 A. Generally, but again I do audits or go to
 9 many different reinsurers, and the exact
 10 dates, I remember some. You know, they
 11 tend to melt together, what happened at
 12 any one given audit. But I do -- I have
 13 been to the Hartford location multiple
 14 times and reviewed files there.
 15 Q. If we can step back for just a second,
 16 you're responsible for deciding whether a
 17 given claim that has been presented to any
 18 of the companies that you have
 19 responsibility for is going to be audited?
 20 Right?
 21 A. If it -- if the claim is assigned to me,
 22 I'll make -- I may make that call, decide
 23 whether something needs to be audited. We
 24 would look at a general book of business.

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1 If balances are creeping up and we're not
 2 getting responses to our inquiries, we try
 3 to set up an audit to try to clear out
 4 those balances to move on, to try to shut
 5 down the claims and keep moving on.
 6 Q. Would it be fair to say that at least in
 7 part the frequency of audits of First
 8 State/Hartford over the last five, six
 9 years has been as a result of the activity
 10 associated with that book of business,
 11 meaning that it has been active?
 12 A. Yes. It is an active book. It involves
 13 most of the entities that we represent.
 14 What we do is we look at the individual
 15 claims, and the individual claim handlers,
 16 whoever may be handling it at one given
 17 time, is attempting to resolve the issues
 18 within those claims, and if the amount of
 19 that book of business starts to grow, we
 20 try and short-circuit all of the what may
 21 be happening with nonanswer of questions,
 22 not answering letters, and requests for
 23 information, by going to the ceding
 24 company and seeing the source documents

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1 and getting our answers from their files.
 2 We find that going ahead and
 3 doing that helps clear up issues. It ends
 4 the -- it ends a lot of the questions back
 5 and forth. And if a ceding company
 6 provides us with everything, it makes it
 7 quite easy, and we do that with many, many
 8 ceding companies, and it works quite well.
 9 Q. Does Nationwide/Wausau/National Casualty
 10 have as its objective -- and I assume you
 11 would be the one to set this policy if it
 12 existed -- are claims audited for the
 13 purposes of finding reasons not to pay?
 14 A. Absolutely not. We're just trying to
 15 clear the balances. We are in run-off,
 16 and we're trying to run off the claims.
 17 We're trying to close them down.
 18 Q. Maybe it would be helpful if you could
 19 explain to the Panel our claim handling
 20 philosophy, generally speaking.
 21 MR. GURA: If I could object,
 22 when you say "our," could you just -- when
 23 you say "our," what are you referring to?
 24 MR. KAREKEN: Nationwide,

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1 National Casualty, the companies that you
 2 have responsibility for.
 3 MR. GURA: Thank you.
 4 A. There is no written policy.
 5 Q. Understood.
 6 A. However, we're attempting to work through
 7 our balances and work through what is
 8 being billed to us in an efficient manner,
 9 and by gathering information and looking
 10 at these individual files, getting the
 11 information we need, work through them and
 12 get rid of them, and the way you do that
 13 is either by paying them or, if they're
 14 not payable, by denying them.
 15 Q. And would you agree with the notion that
 16 our philosophy is that we are the stewards
 17 of the dollars that have been invested for
 18 running off the business that we have
 19 responsibility for?
 20 A. Yes. We have been given the obligation or
 21 the -- we have been given the job of going
 22 out and running off this book of business,
 23 and we're doing it in a manner which is
 24 expeditious and in a manner which is

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1 sensitive to the financial criteria or the
2 financial impact it has. We are moving
3 forward as fast as we can in a sense to
4 put ourselves out of a job.

5 Q. But the primary objective -- you can tell
6 me if I'm wrong -- is that we're supposed
7 to pay what we owe and not pay what we
8 don't owe?

9 A. In its simplest terms, that's it, and do
10 it as quickly as possible.

11 Q. And that philosophy requires that we
12 understand what it is that is being
13 presented to us? Correct?

14 A. Exactly. That is why we ask questions,
15 get documentation, to understand the file.
16 Many of the claims that are coming to us
17 aren't auto claims. I mean these aren't
18 slip and falls where there is what is
19 going on. These are large coverage
20 actions being handled by the underlying
21 cedents with rooms full of documents for
22 one particular claim, and we have huge
23 claims coming to us for millions of
24 dollars, and in order to look at those

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1 claims, we have to get proper
2 documentation, analyze it, and then most
3 likely when they are bigger like that take
4 it up the chain to get support within our
5 company or within our management to pay
6 it, not unlike any other insurance or
7 reinsurance company when they get to these
8 types of large claims.

9 Q. Can you give the Panel a sense of the
10 relationship that you in your position as
11 reinsurance professional representative of
12 the Nationwide group of companies has had
13 with First State over the course of almost
14 10 years now?

15 A. Yes. Again we have attempted to elicit
16 information from First State via written
17 letters. Many times they have gone
18 unanswered. And so we attempted to go in
19 and audit, often by invitation, to come in
20 and get the documentation we need. Many
21 times when we arrive, there are large
22 claim files there filled with documents
23 which are not necessarily germane to the
24 claim. These are the underlying reports

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1 of why plaintiff, 42, John Jones, had
2 meso, and shows his medical report, or why
3 one particular site had an engineering
4 report. It has been difficult. We have
5 -- every time we go, it is sort of like,
6 "Okay, show us the real file, show us the
7 -- show us the DJ file."

8 "Oh, you want the DJ file?

9 Okay." Then they bring that out.

10 "Do you want the account file?"

11 "Fine."

12 We will look at that. We will
13 look on ECLIPS and notice it references
14 another file. We will go and look at that
15 file.

16 So what happens is we end up
17 going there and answering our questions
18 that we have, gathering information we
19 need, to go back, analyze, look at it, get
20 the proper authority, and move forward.

21 And, you know, as I heard
22 Mr. Wigmanich say it today, he said you
23 guys, come out, get the stuff you need,
24 and pay usually. And that's what we have

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1 been doing from since '95 for Argonaut.
2 Then from '96 on, that is what we have
3 been trying, attempting to do, is get the
4 information we need to move forward, and
5 that is what generally happened up until
6 about 2000 when they started to say,
7 "Well, sensitive documents we don't want
8 you to take home; we don't want you to
9 have copies of."

10 So we started to protest that,
11 and say, "No, we need the copies. We
12 need" -- I mean these are documents of DJ
13 files that go on for 10 years and then are
14 finally settled. There are 100 different
15 attorneys' reports. There are case
16 management reports that are filed
17 quarterly, and there are tons of them.
18 For us to sit there and scribe them all
19 out or be able to understand what they are
20 and bring them back to our management and
21 describe them is almost impossible.

22 This just isn't a file like
23 this. It is a room full of documents with
24 things going on and on. And this is after

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1 we, you know, work very hard with the
2 staff at Hartford to gather all of that
3 information and get the files off the --
4 it may be the adjuster's desk or wherever
5 they may be to look at these. When they
6 start throwing in "You can't have this,"
7 we protested.

8 At one point, I worked with
9 Mr. Wigmanich, who -- who said, yes, you
10 know, we understand that you have this
11 need for these documents, and one
12 particular case, he and I struck a deal
13 where he would give me the documents, and
14 then we ended up settling the case, and he
15 signed off on a settlement that said that
16 they would not unreasonably refuse our
17 requests for privileged documents. So
18 that was about 2001.

19 And then getting into 2002, they
20 started to again unreasonably withhold
21 documents. They started to not allow us
22 to have privileged documents. And now
23 Mr. Gura said we are no longer allowed to
24 have any documents whatsoever that may be

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1 has got to be more. Well, there isn't.

2 We're told, "This is all there is." And
3 you can't get any more.

4 Q. You state that you're aware of the changes
5 that have taken place in terms of access
6 to information. Do you recall in
7 conducting audits that you were advised in
8 advance about what the rules would be?

9 A. As a matter of fact, no. The idea was,
10 well, mark them down, and we can work it
11 out. Put them down on the sheet,
12 everything that you want, tag them, and
13 then we can discuss it, sort of like we
14 had done with I believe it was the Waste
15 Management case, which was a large
16 environmental case, and Bill and I worked
17 through it, and I identified certain
18 documents I wanted that we had tagged,
19 that I was able to get my hands on, look
20 at, get the necessary authority I need,
21 and settle that case with Bill.

22 It comes down to being able to
23 get the documents you need to do your job
24 as a claims handler, to analyze these

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1 privileged.

2 And one of the other things is
3 many times I have attempted to argue with
4 Mr. Noga and Mr. Wigmanich and other
5 people on site at Hartford or -- or Mr.
6 Wigmanich is up here in Boston -- but at
7 Hartford while we are trying to do this
8 that these documents aren't even
9 privileged, because they are
10 communications between their claims
11 handlers or nonprivileged documents, and
12 they said, "Well, they're still sensitive,
13 so we still just don't want to show them
14 to you."

15 We attempted to work through
16 that. I thought we had it worked out.
17 Then by 2002 they were back at it again,
18 not showing us or not allowing us copies,
19 number one, and again it is very
20 difficult. Every audit you go to there,
21 there is a room full of documents, but
22 those documents may or may not be
23 responsible for what you need. And you're
24 not -- many times it is -- you say there

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1 claims, and make a determination to move
2 forward. This just puts up roadblocks to
3 try to do that process, and it is really
4 unfortunate that these roadblocks are now
5 put up, that we are not allowed to have
6 anything privileged, I assume anything
7 sensitive, and that what we are going to
8 be able to see is very little, because
9 that is where all the, you know, that is
10 where all the good stuff is, where the
11 attorneys are talking to each other, the
12 clients are talking to the attorneys, they
13 are discussing strategy, they are going
14 back and forth. That is where the meat
15 and potatoes of the claims information is.

16 Q. Have you considered the history of this,
17 and more specifically in the context of
18 this case and these claims, how these
19 policies that First State has implemented
20 correlate to National Casualty's rights
21 under the contract that it signed with
22 First State?

23 A. Yes. I mean clearly they're breaching the
24 access to records. It clearly states that

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1 we shall have access to the records. I
2 heard Mr. Wigmanich talk about, well, it
3 doesn't say we can withhold. Well, there
4 is no qualifier. It says we have access
5 to records. They can't unilaterally
6 change the contract 25 years later. I
7 mean that is ridiculous.

8 I understand they have concerns.
9 Other cedents have had concerns in the
10 past over the same issues, and we have
11 always been able to work it out. In the
12 past, we have also worked it out with
13 First State. But now --

14 And I still don't understand.
15 They claim that it is related to asbestos
16 nonproducts, but I understand from what
17 Mr. Wigmanich said that now -- and what
18 Mr. Gura said -- that now we can have
19 nothing regarding any claim, whether it be
20 -- whether it be nonproducts or not.

21 Q. You mean we can't have access to any
22 privileged?

23 A. Exactly.

24 Q. You can't have any claim information?

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1 have, and we have hundreds of ceding
2 companies to us, that actually won't have
3 us -- won't give us any documents that
4 they claim to be privileged. First they
5 claim they don't have them. Then when we
6 discover some, they say, in fact they're
7 privileged; you can't see them.

8 But that -- the industry works
9 with people exchanging information and
10 going forward and working on claims, and
11 that's 99 percent of the industry does
12 that.

13 Q. You have looked at the treaties at issue
14 in this case, and did you see in any of
15 those three where National Casualty had
16 been granted the right to dictate to First
17 State which risk it would underwrite and
18 cede to the treaty?

19 A. No. They have underwriting and claim
20 control, and our only -- the only thing we
21 have rights under our contract would be
22 the right to come in and look and see what
23 they're doing, see what they're doing for
24 claims, see what they're doing for

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1 A. Exactly.

2 Q. Do you have an understanding, aside from
3 the access to records clause, why
4 information and complete information is
5 important for us to be able to do our job?

6 A. It is what we do as claim professionals.
7 It is what Mr. Wigmanich does as a claims
8 professional. It is what the whole
9 industry does as claims professionals.
10 They gather information; they analyze it;
11 and they make a call. And without the
12 information, without being able to see it,
13 without being able to see the meat and
14 potatoes of those claims files, you can't
15 do your job as a claims professional. It
16 puts a roadblock up to say, "Well, you
17 can't see it all, so just pay it." Well,
18 that's --

19 Q. And -- I am sorry?

20 A. No one in the industry does that, and the
21 only other -- the only other place where
22 that has come up, as they have talked
23 about, is with The Travelers, and that's,
24 you know, the only other ceding company we

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1 underwriting, and that's why the access to
2 records is so important is they have claim
3 and underwriting control over these
4 specific claims.

5 MR. KAREKEN: I don't know if
6 the original is up here. I will hand you
7 my copy of Exhibit National Casualty 147,
8 the Strain definition of utmost good
9 faith.

10 (Handing NC Exhibit No. 147 to
11 the witness.)

12 Q. I wonder if you could explain to the Panel
13 how you place that definition into this
14 access to information, change in policy,
15 no-you-can't-have-anything type of stance
16 that we're being confronted with.

17 A. Clearly Strain's definition here is right
18 on point. As a graduate of the Strain
19 seminar, I would wholly endorse it. But
20 also it talks to, you know, the idea of --
21 he misspells it here -- but candor and
22 openness, good faith, absolute and perfect
23 candor, honesty, openness, absent of any
24 concealment, however slight.

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1 In order for us to do our job,
2 there has to be this ability to go in and
3 see what they're doing, and for them to be
4 open and honest, and they're not being
5 open. They're not allowing us to see what
6 they're doing. Again these are the --
7 these are -- the documents that we're
8 trying to look at are the documents which
9 they claim privilege to are the meat and
10 potatoes of these claims. That's the --
11 the discussions with counsel are
12 discussions with internal counsel, the
13 discussions between each other that
14 discuss their positions, and those are the
15 ones they don't want to show us, and in
16 the absence of those type of documents,
17 we're left with -- and pollution claims, a
18 bunch of environmental site files, or in
19 asbestos, you know, maybe some CCR
20 reports, and that's about it, or whoever
21 is handling the claim, the underlying
22 claims.

23 So we end up in a situation
24 where there is no utmost good faith here.

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1 There is no -- there is active concealment
2 of what they're doing. There is no
3 openness. There is no disclosure of all
4 relevant facts. And we signed an
5 agreement a long time ago which provided
6 for access to records, and they're now
7 breaching that. They're attempting to
8 change the contract, and they shouldn't be
9 able to do that.

10 Q. What do you think about the idea that was
11 alluded to and/or stated expressly by
12 Mr. Wigmanich that in effect once you get
13 their reinsurance report we have all the
14 information we need?

15 A. Well, reinsurance reports from The
16 Hartford vary from handler to handler, but
17 basically, they're making conclusions.
18 They will just say this is the conclusion
19 and this is what we paid, so you now pay.
20 You still have to look at the underlying
21 documents that support that to understand
22 the claim, to see how it got from the
23 initial whatever its filing of DJ or
24 demand for coverage to the point where it

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1 ended. They just have a synopsis of what
2 happened in the end. We need to know the
3 whole story to see what happened, to
4 understand the claim, to see where it
5 ended up, so we can make a call on it on
6 what to do. As Bill said, after we have
7 had that full disclosure, we usually pay.
8 That's what we do.

9 Q. Okay. And other than perhaps the claims
10 at issue here, okay, which if you remove
11 OCF from doesn't amount to a grand --
12 grand sum of money, would you agree?

13 A. I would agree.

14 Q. And OCF we issued denial on in what year?
15 Do you recall?

16 A. 2001 or 2002. 2002, I believe.

17 Q. So it was denied obviously before the
18 arbitration demand for resolution of that
19 claim?

20 A. Correct.

21 Q. What do you think about the idea which
22 seems to be the centerpiece of First
23 State's position which is that since we
24 have been shown the privileged documents,

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1 okay, and we haven't said, well, in this
2 one that we saw there was such and such
3 and, therefore, ipso facto, okay, the idea
4 that we should have to argue to this Panel
5 or any Panel that we saw a document, that
6 we claim that it contains certain
7 information, but not be able to show the
8 Panel what it is and allow them to see
9 whether they agree with our interpretation
10 or not?

11 A. Well, I think it was important to note
12 that, you know, that there is a
13 representation that we have seen
14 everything on there, but we don't know
15 that. In fact, when we go and look at
16 individual files, especially prior to the
17 arbitration demand, you know, as I said
18 before, it is difficult to get the
19 documents. It is difficult to get the
20 files. We have been given partial files,
21 or we can't find this. We have had --
22 when we go to Hartford, they say it is in
23 Boston. When we go to Boston, they say it
24 is in Hartford. We can't be sure what

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1 we're getting from time to time when we go
2 there, number one.

3 And number two, the idea that we
4 may not have seen it flies in the face of
5 when we go there we're looking at these
6 individual claim files, and we find
7 something good, and our instructions are
8 to tag it, and we'll talk about maybe if
9 we'll produce it or not, and, you know, we
10 had the assurance by Mr. Wigmanich in
11 writing that we won't unreasonably
12 withhold privileged documents, and that
13 was in 2001 that he did that.

14 So, you know, we're looking at
15 the OCF claim. I think it is fair to
16 assume that it is a big claim, and we're
17 going to want privileged documents, and,
18 you know, to say that we have them or we
19 shouldn't be able to view them is
20 ridiculous, because again it is a huge
21 claim with lots of documents, and, number
22 one, we don't know what is on the
23 privilege document list is stuff we
24 actually saw, and number two, of course

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1 anyone looking at the file wouldn't be
2 sitting there taking down verbatim what
3 was there because we understood from
4 Mr. Wigmanich that they, First State,
5 wouldn't unreasonably withhold documents.

6 Q. And you have looked at the privilege log
7 in this matter, haven't you?

8 A. Yes.

9 Q. Can you tell from looking at that log
10 whether anything on there is anything that
11 you saw in connection with any of your
12 audits?

13 A. No. Looking at it, you can't tell what
14 claim it goes to, if it is A. H. Robins or
15 OCF. There is the one with the Bowman one
16 that kind of -- Mr. Gura has said is that,
17 and there is an assumption that it is
18 that, but we don't know if it is or is
19 not. Again we don't know what claims they
20 go to. We don't know if there are files
21 or documents withheld, to what claim, or
22 for what purpose, or -- it is too
23 ambiguous to know.

24 Q. Now you heard my discussion with

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1 Mr. Wigmanich about the concept of follow
2 the settlements and follow the fortunes.

3 Do you remember hearing that?

4 A. Yes.

5 Q. And I tried to draw a distinction for
6 Mr. Wigmanich between what is an
7 acceptable application or what follow the
8 settlements is intended to apply to versus
9 something to which it does not apply. Do
10 you recall my general discussion in that
11 regard?

12 A. Yes.

13 Q. Do you recall that I said that it is one
14 thing to tell the ceding company that they
15 shouldn't have settled or that they
16 shouldn't have settled on a particular
17 basis, being that we don't owe it because
18 you did that?

19 A. Correct.

20 Q. Versus saying to the ceding company, you
21 settled the claim, that's fine, okay. We
22 don't quibble with the fact that you had
23 to make a choice about what you were going
24 to do. But when you bring the loss to us,

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1 follow the settlements doesn't override
2 the terms of our contract with you; in
3 other words, follow the settlements does
4 not allow you to supersede, overrun,
5 overcome terms that are spelled out in the
6 treaty? Is that --

7 A. That's correct.

8 Q. And has that been your understanding of
9 the way that follow the settlements
10 operates since you became familiar with
11 the concept?

12 A. Yes. And we're not second-guessing the
13 decision to settle or the underlying
14 amounts or that a particular site had so
15 much damage at it or that these BI
16 asbestos claimants were in fact injured or
17 not. We're not second-guessing that.

18 Q. And you have seen the various letters that
19 have been identified as our denials?

20 A. Correct.

21 Q. And presumably you would have seen those
22 before they were even sent? Correct?

23 A. I guess that's a fair assumption.

24 Q. Well, you may or may not have?

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